

**SBA 101: All you Ever Wanted to Know About  
Being an SBA-Certified Lender**

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Gigi Hyland: Good afternoon everyone, and welcome. My name is Gigi Hyland. I am a board member with the National Credit Union Administration and in that capacity I serve as board liaison to the Small Business Administration. And today I am going to be facilitating this webinar, which is entitled 'SBA101, all you ever wanted to know about being an SBA certified lender. And joining me today is John Wade to my left who is with the SBA. Welcome John, we are happy to have you with us.

John Wade: Thank you.

Gigi Hyland: The genesis for this webinar really came about from conversations that I had with credit unions. Many have expressed an interest in business lending and gaining more information about the SBA programs and how to become an SBA certified lender. Therefore today, we are going to focus really on three main topics. First and foremost, we are going to look at the different SBA programs and how a credit union would go about becoming an SBA certified lender. We are then going to turn to NCUA's member business loan rule and have a brief discussion on how that rule was changed in 2004 to accommodate credit union's interest in SBA lending. And then finally, we are going to give you some insight as to what our examiners look at, NCUA's examiners look at, when they come into your shops and look at member business lending as well as any participation you may have in SBA programs. The webinar is actually designed to be interactive and you will notice on your screen that there is a place where you can type in questions as you are watching and press the 'Submit' button to give those to us. We would urge you to do that. What we are going to do is we are actually going to run through our presentation because we may be answering questions later on in the presentation and hopefully, we will have a chance to do that. And then at the end, we are going to save about 20 minutes to look at the questions that you submitted and hopefully get a chance to answer them all. With that, let's get started. First, I am going to turn to John. And let him run through his presentation to talk about what are the criteria for becoming SBA certified lender and to give us some sense of the different SBA programs. John...

John Wade: Thank you Gigi.

Gigi Hyland: You are welcome.

John Wade: I would like to thank, first of all, board member Hyland and everyone here at the NCUA for giving the SBA an opportunity to use this forum to describe our process for credit union participation in our SBA lending programs. Now I have entitled the presentation 'Credit Unions and SBA: A Solution to Managing Risk in Business Lending' to really highlight the business benefits of SBA lending in a credit union operation. A lot of other things we have noticed as we developed a relationship a, continuing relationship with the credit union industry is that there seems to be a buzz about regarding credit unions moving toward becoming more of a financial service intermediary. The small businesses they have as their members have developed close relationships with these credit unions based upon the true commitment to service. In fact, the credo that we are accustomed to hearing is this 'Not for profit, not for charity, but for

service'. We recognize that the SBA participation can compliment a credit union's existing commercial lending operation and that the SBA's full-faith guarantee lessens the risk element that's involved in making a tough credit. Now to give you some perspective as to just what kind of growth we have seen since this development of the credit union business with the SBA has taken shape, I would like to refer you to some statistics that I've been able to pull down both from the NCUA as well as from SBA to share them with you now. If you refer to the credit union statistics for financially insured credit unions as of December 2005, you will note that the net member business lending currently is listed at 97,374 loans for \$15.1 billion. Now that 97,374 loans represent 2% of the total loans and 3.3% of the dollar value involved, a significant sum from what it was a few years back, but maybe even more impressive for us has been the fact that the SBA lending from the credit union industry has grown immensely since fiscal year 2001.

Let me share some statistics with you here. In fiscal year 2001, at the end of the fiscal year, we had 71 credit unions registered as lender participants. Of those 71, 17 of them generated 97 loan approvals for \$13.2 million. Let me take you now to the last month of fiscal year 2006 here, where we have 310 credit unions now listed as registered lender participants in the SBA 7(a) program. A 108 of those have done loans this year, 1297 loans have been approved for a \$121.3 million. That, ladies and gentlemen, is an understanding that we know that member business lending truly is growing and small business is the primary beneficiary. Now why SBA? It's probably a very good question, a lot of you probably have asked yourself. Well, the SBA product, as I mentioned, does complement your existing commercial business-lending unit. And our guarantee is really looked upon as a way for the credit union to lessen its risk. Now, let me introduce for you the three product lines that we know in our SBA lending programs. The 7(a) Guaranteed Loan Program, 7(a) for those of you who read our statute, it is section 7(a) of the Small Business Act of 1953. There is also the Certified Development Company or 504 Program, which was established in 1958. And then there is the SBA MicroEnterprise Lending program. Let me take you first to the 7(a) program.

The 7(a) program is the flagship loan guaranty program of the SBA. This year's, fiscal year 2006 volume is upwards of \$15 billion in approvals and upwards of 100,000 loan approvals in total. You will notice from the slide here that the guaranty percentage for our SBA loans range from 50% to 85%. And when we talk about SBA loans, we refer to them in three general contexts, a regular 7(a) processing, the preferred lender or PLP processing, and SBAExpress. You will notice also on the slide that we are looking toward a centralized processing of our regular 7(a) loans, beginning with this phasing of this process in January 2007. Now the 7(a) product, as I say, is a loan guaranty that's offered to the credit union to induce the credit union to make the loan that they would not normally make otherwise to a small business concern. Maturities can range up to 25 years in some cases and are primarily variable pricing over prime. Compare that, if you would, with the SBAExpress product. Now, the SBAExpress product as it's referred to on the slide is your forms and our guarantee together, so that loans could be made of amounts up to \$350,000 with a 50% guarantee. The credit union, and this we think is one of the great features of Express, the credit union can use its own forms and its own credit evaluation method. This is a very critical point, because it makes it possible for you to

essentially morph your existing conventional unit, and specifically the process that you go through for your conventional unit right to an SBA product. The loan maturity on these loans is based on the nature of the financing, but can be up to 7 years and the pricing can range from 4.5-6.5% over prime.

The other program I would like to discuss is the 504 Project Financing. As you will note, it's a combination financing of fixed assets projects. Credit unions would hold a first mortgage interest with no more than 50% of the project cost associated with that loan. The SBA Certified Development Company, which would be a licensed company with the SBA, provides subordinate financing, which is then sold into the public market with an SBA guarantee attached to it. The small concern or the proprietor for the small concern would then have the residual financing or the residual funding requirement. The third element, and the third arsenal that we have is our Micro Loan or MicroEnterprise Loan Program. In this particular case, the SBA, finances a non-profit entity that then makes small loans, very small loans of no more than \$35,000 to microenterprises. These loans would also include technical assistance that has been provided to the small concern. We find that this is a program that really is attractive to those particular industries and those particular micro concerns that really have a great idea, have germinated that idea, but really don't know where to go next. And in a lot of the cases, the Micro Loan Program is a perfect fit for this particular type of small concern.

For us then, just take a look at the credit union participation in the SBA 7(a) program. I am going to refer you now to the slide again that you will see on the screen. Our application process is a little different than what we do for our other traditional lenders. The application process does include commercial credit policies of submission, your commercial credit policies, legal filings, recent call report data and your NCUA share insurance certificate. Now, one of the things we look at when we evaluate these forms, and one of the reasons why we have delays, is really because some of these documents probably are so accustomed to you, you probably forgot where they are in your operation. Ironically, the share insurance certificate seems to be one of those types of documents. Nonetheless, we have been able to work with the NCUA to find out that these types of share insurance certificates can be made available upon your request to the NCUA at any one of the regional offices around the country. The other document though that I really want to spend time with you on is a document that we have regarding a statement from an authorized credit union official that the credit union is not primarily engaged in the financing of an affiliate. Now, a lot of people have asked us the question over the course of the five years, what does this have to do with credit unions? And it's a reasonably good question. It was really designed though to ward off the use of our 7(a) program by captive finance companies who saw it as an attractive way for them to use the guaranty and to ward off a lot of the risk that they were going to assume on their own. And so with this, we devised in our regulations a certification. A certification signed by the individual who has been authorized by the board to sign on behalf of the credit union, that says that they either do not have affiliates or if they have affiliates that they are not primarily engaged in the financing of that affiliate. It seems to be one of the bases for why loans...when credit union applications come to my office, why I am on the phone calling back to either our district offices or to the credit union participants themselves

asking them for this type of information. I must tell you it's a bit difficult to explain that one.

The other thing I am looking at though, you will be aware that I will be looking at each one of these credit union applications as they come to headquarters, is the lender's capabilities, that is, do you currently or can you operate all facets of a commercial lending operation? Seems pretty straightforward. In fact, I've had some people even tell me that 'Oh, it's just as same as a consumer loan,' and I keep trying to tell them, 'Well, it's not really built that way.' But we do want to look at the capabilities because we want to make sure that you are going to use this program and be able to use it as a complement with your existing conventional program, so that in situations where maybe there is not a right fit for structure purposes or for pricing purposes that the SBA product might be a very convenient alternative.

Now, the question also has risen over the course of five years, well what about third party service providers? What about CUSOs? And we have addressed this in a presentation here that all CUSOs and third party service providers truly can help these credit unions. But we want to ensure that it's clear to the credit union that the privity of contract that the credit union has is with the SBA directly. And that the SBA will look to the credit union itself for any type of actions or omissions of actions that are performed in the course of making SBA loans. Well, what does that all mean? Well, it means when we look at capabilities of the lending institution, one of the things I am looking for is whether there are sufficient internal controls that are placed upon the third party service provider, so that you have a full understanding and accounting for what's going on in these CUSOs or third party service providers. So what would be the steps then for becoming an SBA lender participant? Well ironically, the first step you make is to actually take an opportunity to contact your district offices. There are 70 of them located throughout the 50 states of the nation and contact your district office with your application. Now, as I say, we have plenty of material on where and what specific elements are in that application. It's certainly not very laborious, but you will make contact with your district office because they are the ones who really are our eyes and ears in the SBA and know exactly what's going on in your local community with regards to small business lending. And to that end, we want to make sure that they have an opportunity to meet with you, to talk with you, to ask you questions about the types of lending you've done. Because I think it's going to give us a lot of opportunity to determine whether this is a program that really will work for you, and it will work because you got prior experience in this.

Now as I referred to before, what could create delays in this whole process, because the next step is to go to headquarters for a final decision, and well it looks like it's just pretty easy on the screen, it's just three simple steps. There are delays that come about. Again, some of the delays are simple filing or compulsory delays. Other times, we'll have to take a look at the statement of affiliates. Or in some cases, we'll have not done the best job of explaining to you that there is a difference between policies, or an outline of what you want to accomplish in the way of a business lending policy. And even in the most remote case, we have received as a policy, a rate sheet. Now that kind of takes the spectrum for you as to what we would receive as policies and procedures. Again, what

we are really trying to do is determine capability. There is a regulatory requirement that we all fulfill at the SBA that asks us to ensure that each lender participant, whether they be credit union or otherwise, has a continuing ability to make service, liquidate a small business loan.

Okay, so you have gone through the process of having your district office filing. You've actually had headquarters notify your district office that you have been approved for lender participation. Okay we're in, what's next? Well, there are a couple extra things that we would like to make sure that you have available before you start sending in the first application for submission, the least of which is SBA lender training. We want to make sure that when you go to this training, you have an opportunity to understand the precepts of what SBA lending is about. It's a little different piece than what you are used to, certainly in the conventional side. One of the most primary tenets of this program is that the loan being offered with a guarantee from the government is being provided because there is no other credit elsewhere under these terms and under these conditions, and you could not have been able to make this loan without that. I think it's important to understand that, because again, this makes the idea of an SBA product a nice complement to an existing line that you may already have and it really won't dampen the growth that you might be seeing already in your member business lending activity.

A second precept that we want to impress upon all of you is this primacy of cash flow lending, okay. The SBA does not have a set loan to value or debt equity ratio established in its program for loan guaranties. But what we want to make sure is that there is reasonable repayment ability available. And this is done from the traditional cash-flow analysis that you do of the underlying small concern. The third element and the third precept, I think that's important to understand especially as you go through our training, is that we make this distinction between program eligibility on the one side and credit worthiness of a loan on the other. There are specific rules, regulations that we have regarding where our loan proceeds can be used, what types of businesses and what types of businesses we do not want to see those loan proceeds used for, and those are eligibility concerns. One, obviously that comes to mind would be the size of the small business. These are the types of programmatic concerns that you should be addressing really with your small business applicant, even before you get to the point of determining the credit worthiness. Because no matter how creditworthy the applicant could be, if they are not eligible for a small business or an SBA loan, it will make no difference as to what their credit worthiness would be. One of the things we would like to pitch, because we have had this opportunity is the sourcing channels. One of the things we've watched in the five years as this program has developed in the credit union industry is that there seem to be a lot of people who are interested in signing up. We are thrilled to have you aboard. But now we would like to take you to the next step and have you take a look within your own operation to determine what are the internal sources that you have or lead points for SBA loan making? I think if you examine that closely, you will have a better appreciation for where it is that the SBA loan product can be introduced? Now, somewhere in the process of making this application, I would assume that the board has taken on the responsibility of saying, "You know, this is a type of product I think we could incorporate into our practice." But more importantly, it's one that we want them to

continue to be thinking about as they start making these loans, that is that there is a strategic reason for why the SBA product fits within the commercial lending practice. That is not just an operational or tactical idea, why because this is what everybody else has been talking about at these specific conferences.

The third element on our slide is, does our 'no' really mean 'no'? I think what you are going to find, if you look at loan denials that you have done on conventional loans, you will find that there are many cases where maybe the structure wasn't going to work, maybe the pricing wasn't going to be reflective of the risk for this particular loan. The SBA is designed to accommodate those things. Does it make us a lender of last resort? No, not by any means. But what we want to be able to do, is to know that before that member walks out the door and has to go to another source of lending for capital that you had to take...have the opportunity to take a chance with the SBA part (ph) and say, maybe this can work, maybe there really is repayment ability. Instead of a five-year loan or a seven-year loan, maybe if this particular feature is eight years and seven months. The SBA product is designed to accommodate that, provided there is reasonable repayment ability and that's an important characteristic I think we tend to underestimate, but I know it's very attractive to those participants who come into our program. I have put together a slide here on current topics of interest because many of my colleagues at the SBA have asked, "Well, don't forget to tell them about the loan reporting requirements. Make sure that they know that the only way we really track the success of a particular SBA loan is on the reporting requirements that are done monthly". We have something referred to as an SBA Form 1502 Report, which is completed each month and is sent in to our fiscal transfer agent, which provides us with information on your entire loan portfolio, not just those loans which are sold in as secondary market transaction. But we use this reporting element to send that information back to the SBA, so our loan accounting data can be reflective of what is exactly going on with the payment histories of the SBA loans you have dispersed in the credit union.

One of the other topics that comes up is loan participations. I have seen a number of policies and procedures inside of many of these credit union applications. They are fabulous to read, but one of the things I think is important for me to stress is that a loan participation in SBA at this time is only permissible amongst other SBA lender participants. That is, there is no portion of an SBA loan guaranteed or un-guaranteed that may be participated with any other credit union unless that other credit union, if that is a participant in the sale, is also an SBA lender participant. It's an important distinction to make. Speaking of participations, when does SBA participate? It's also a good question. If you will think about it, you've gone through the whole process of putting a loan on the books. You have gotten the SBA guaranty, at least acknowledged the guaranty, but SBA hasn't put in any money into the deal yet. Well, that does take place and it takes place whenever the loan goes into a series of defaults and specifically financial defaults. Currently, the SBA regulations require that if a loan payment goes more than 60 days in arrears that the lender participant may come to the SBA on a written request and request that we participate or purchase our guaranty interest. When we do this, we are then going through the exercise of becoming a holder in the majority portion of the loan. And it is from that point forward that the lender participant, credit union in this particular case,

continues the liquidation exercise with the understanding that as proceeds from a liquidation take place, those proceeds are then distributed pro-rata based upon the ownership interest between the SBA and the lender participant and the respective guaranty percentage that was paid on that. And one of the things that I always like to share with a group when I am talking about SBA lending and specific for credit unions relates to this idea, well how do I know if my guaranty is good or is effective? And one of the last comments I list on this particular slide is document, document, document.

One of the things that I have learned in the course of my 12 years in the government service is that the more information you can provide to us that reflects your level of thinking, that is what you were doing when you made decisions, favorable or unfavorable, the better off we are in knowing or can reconstruct that thinking when we go through a process of determining. When we made payment on a purchase guaranty, was the lender participant following all of our rules and regulations? And if so, we stand ready to honor that guaranty. That's why it's always very helpful, as you would expect that a government program like this would always encourage you to make sure you document your decisions, so that we have some understanding, when we have a chance to take a look at the file, what things you were thinking about when you took the actions you did.

So how can you succeed at this? Well, as it says here on the slide, first contact your SBA district office. They are our eyes and ears. They are the ones who know more about the local business community than anybody else in the nation. We would like to think that we know something at headquarters but I can tell you right now, our districts are much better suited at this than we are. Make sure that you use that district office as your source for training, okay. And that there is additional information for you in the way of additional arsenal, the additional arms that we provide to you, not just for you as a credit union lender participant, but also for your small business borrower. Again, with credit union is being designed around the idea of service, service to their members, the SBA has a range of services that extend well beyond capital access that we make available, whether they be through entrepreneurial development or government contracting. And these are services that are...and information that's made available to each of you through our SBA district offices. So please, make sure you contact that district office. They have got a wealth of information. Information that many people don't even know that's really available to them but it's right at your doorstep.

Okay. Now, I have also presided for you on the counsel here information sources. Those of you who like to read our material you are welcome to go through this. It would be worthwhile I think though just for everybody to be acquainted with the fact that the Small Business Act was established in 1953. It has been amended. However, it does still have the tenets of what this program is designed to do. We also have a series of regulations captured or codified in the code of federal regulations, CF...we call 13 CFR Part 120 in particular. You will also notice that we have standard operating procedures. I know they are very voluminous, but it really is important for you to at least know specific sections of those because they really give you the guidelines behind much of the regulation. And I think it gives you a lot...a better understanding as to what's our thinking as we go

through this process of determining credit eligibility...program eligibility or credit worthiness on a particular loan. Why is it that we are interested in knowing just how you are servicing that loan and whether a servicing action is really going to be in our best interest or not once that loan is guaranteed. Much of this information is made available to you through our standard operating procedures and all of our district offices, including some of our headquarters people are very well suited, being able to address many of your questions. As I also note on the website, you can see that we also have a hyperlink, a hyperlink to a library inside the [www.sba.gov](http://www.sba.gov) website. If you really want to get comfortable with what the SBA provides and what kind of information is available to the SBA, not only for the capital access programs, the loans and investments themselves, you can take a look at this library, which provides much of the same information as listed above. Thank you Gigi.

Gigi Hyland: You are very welcome. Thank you John. That information was very informative and hopefully helped our audience out there to understand better not only SBA programs, but also what some of the requirements are in terms of being an SBA lender. With that, I want to shift gears just a little bit and for many of you who are out there, you may be thinking it's great to hear from the SBA, but the NCUA is my primary regulator and I really care about what NCUA thinks about all of this. So what we are going to do is, we are going to switch gears a little bit and hopefully we are zooming out so that you can see the two additional participants that we have. I have actually invited two experts from the NCUA to join us to talk about some of those issues. To my direct left, over here, is Frank Kressman. He is a staff attorney with our Office of General Counsel and to my right is Cory Phariss, who is a program officer with the Office of Examination and Insurance. And Frank is going to talk a little bit about the member business loan rule and some of the changes that we made, we being NCUA, made in 2004, to accommodate the programs that John was talking about. And I am going to turn it over to Cory to give you a little insight into the examination perspective and what examiners look for. So with that, Frank, I am going to turn it over to you.

Frank S. Kressman: Thank you.

Gigi Hyland: You are very welcome.

Frank S. Kressman: In giving a brief overview of member business loan rule, it's probably necessary to put it in context. Credit unions exist to lend money and lending money is a risky business. So throughout NCUA's rules, we have risk mitigation regulations that apply to lending so that in that risky process there are certain safeguards that credit unions will take to protect themselves within the general gambit of lending. It's a more specialized kind of lending member business loans. And member business loans historically are a more complicated, more risky type of loan than your traditional consumer loan. And as a result of that, in addition to general lending rules, NCUA also has specific member business loan rules. Back in 2003, while conducting a rulemaking on the member business loan rule, one of the comments that we received from the general public was that the credit union would have liked to have made more SBA guaranteed loans. But they didn't think that the member business loan rule was well aligned to the

SBA's programs and thought that our rule was an impediment. At that time, we were unable to address that in the current rule, but we promised that we would look into that and that's exactly what we did. In 2004, we in fact amended NCUA's member business loan rule in order to better align it with SBA's programs, so that credit unions could more fully participate in those programs. One thing that I think of particular note is we tend to get lots of questions and comments from the industry asking us to change the member business loan rule in a variety of ways. And we often do so for the best interest of the industry in terms of protection and allowing maximum flexibility within safety and soundness. But we also need to stress that a good portion of what is structured in the member business loan rule comes directly from the Federal Credit Union Act. So those statutory limitations are actually limitations that the NCUA has to operate within as well. Before we went ahead and amended the member business loan rule, we took a good close look at the SBA programs because we wanted to be sure from a safety and soundness perspective that we are moving forward in a prudent manner. And what we found after a close inspection was that the SBA programs were in fact very conducive to credit union participation, both in terms of making the loans and also being able to comply with the SBA's criteria. And also we saw that the SBA's programs were actually ideally suited to the mission that many credit unions have which is to serve their members business loan needs. Now very specifically, after we determined that the programs were a good fit for credit unions, we made two technical amendments to the regulation. The first one is, we said, if credit unions were participating in an SBA guaranteed loan program and if that SBA program happened to have loan restrictions that were less burdensome than the MBL rule that the credit union could use those. And in tandem with that, we indicated that the collateral...security requirements that are built into the member business loan rule would be exempt from SBA program loans. And we think the two rule changes really put our rule and the SBA's program much more in a connective position so that credit unions have the opportunity to more fully participate in the SBA program without being hampered by unnecessary restrictions in our own MBL rule.

Gigi Hyland: That's great. Thank you Frank very much. Cory, I am going to turn it over to you to give us a little bit of perspective on knowing what the due diligence requirements are for credit unions, but also what examiners like to look at when they go into a credit union? So, let me turn it over to you.

Cory Phariss: Sure, thank you. Really due diligence for member business lending and SBA lending, as a subset of member business loans, is really not unlike due diligence that you do for any new loan program. We would like to see that before a credit union is engaged in member business lending, they ask themselves some basic questions and answer those questions. To echo the sentiments of John earlier, in a documented fashion... document, document, document. As you go through these questions, I encourage you as a credit union to document your answers, your discussions in board meetings and board minutes, your discussions in strategic planning sessions and in your strategic plan. These questions and the answers to the question as you go forward. First, we want to see that credit unions ask themselves, what do MBL offerings really help us to achieve with regard to our strategic goals in our overall mission? Which members are going to be served, which potential members can we reach out to with member business

loans or SBA programs? Secondly, we want to see that you are asking, if you have the appropriate experience at hand or at your disposal, to manage member business lending programs. Will we use internal or external expertise and what cost will be associated with maintaining the appropriate expertise necessary to meet regulatory or soundness guidelines. We want to see that you have estimated the potential and desired financial impacts of the new program, that you've thought about what's likely to happen and what the best and worst case scenarios are, but ultimately that you have given some thought to what you eventually hope to accomplish from a financial and strategic perspective when you offer a new program.

And the last two questions on the slide really deal with credit union infrastructure. We want to see that you have...as a credit union, you want to ask yourself if you have the adequate infrastructure to segregate, track, and monitor loans for both performance and reporting purposes and as John mentioned earlier, reporting to the SBA is very important, but also reporting on the NCUA's 5300 call report. And also you have the operational internal control structure available to ensure that your loans are being serviced properly. And that documentation and loan covenants are being tracked and enforced. If you don't have an infrastructure in place, what is it going to cost?

And so with that, I will move to what an examiner likes to review? What sound business practices an examiner would be looking for when he comes to your credit union, he or she comes to your credit union? I would like you to remember that documentation is a proactive step that you can take to help your examiner understand your train of thought. The examiner hasn't been in the credit union since the last exam and may not realize all of the planning and thought that you have given to these programs, and so your documentation will help you to demonstrate your knowledge, skills and abilities are up to par to run this program safely and soundly. Of course, examiners are going to be interested in your strategic planning and due diligence process. They are going to want to see that the credit union has considered member business lending in SBA programs with regard to the larger context of this overall mission and that the credit union has weighed the risk and rewards. But perhaps most importantly, an examiner wants to see that a credit union can demonstrate an understanding of the programs that it adopts. With SBA loans being relatively new in credit unions, keep in mind that SBA loans while growing in credit unions, (really represent only about 1% of total member business loans) examiners are going to want to know that you have a good comfort level with what you are doing with SBA and that you understand the processes upfront and also at the end of the loan process, if you have to ask the SBA to purchase a guaranty. Examiners will also look at staff experience. They'll look at the two-year requirement that's in the regulation. But they will also look to see if the experience of the staff, either internal or external, matches the type of lending, and the breadth of lending that the credit union is engaged in. They will do the same things with the member business loan policies and procedures. They will look to see if they meet the regulatory requirements that are listed in the regulation for federal credit unions, and for those credit unions that are regulated by NCUA's Rules and Regulations, Part 723, the regulation is fairly specific with regard to what should be in the policy. But the examiner will look to also see in addition that the policies and procedures you have in place, addressed the credit union's risk profile on the

type of lending that you are doing. From an underwriting perspective, the examiners want to see, in some ways, some of the same things that we look for with consumer underwriting, who want to see that the loan is being made for a prudent and productive purpose. They want to see that you have all of your documentation in place and that the appropriate loan covenants are in place for member business loans. And also that you have looked at the old traditional 5 'Cs' of credit, capital, capacity, cash flow, capacity and cash flow are highly interchangeable, we'll touch on that again in just moment, character, collateral, and the conditions of the loan and the environment that the business is operating in.

From the monitoring and servicing perspective, examiners are interested to see that you have a process in place to ensure adherence to covenants, to make sure that your member borrowers are adhering to the covenants that you have put in place in the loan, that insurance is in place, that lien filings were in place and up-to-date, that financial statements are being obtained and reviewed and that...there is an analysis that comes with that review, that there are periodic collateral evaluations, communications with the MBL borrower, internal risk ratings, and importantly for SBA loans, we want to make sure that you understand the SBA's standard operating procedures for servicing. John referred to those earlier and we can read up on those. But examiners will be interested to see that you are doing that servicing and you have a process in place to monitor how well you are doing it.

From an internal control and monitoring systems perspective, we want to see that you have processes in place to ensure not only compliance with regulation, but internal loan policies and also your agreements with the SBA, and the requirements that they have set forth in their standard operating procedures. Finally, of course, examiners are interested in the financial and strategic impact of a program once it's been put in place. Has the program the desired financial effect? Does it have the appropriate or desired member service effect? Are we doing the things we wanted it to do when we first set out to initiate the program? An important thing for an examiner to see is not only that the credit union has made appropriate financial strategic progress with the program, but that they have monitored and analyzed the program along the way and made little adjustments to make the program better, when there have been mistakes or problems.

With that, I would like to talk a little bit about some of the mistakes that we commonly see and mistakes that we hope you will avoid. Some of these may have seem remedial to some of you who have member business loan programs in place and have had them for a while. But it never ceases to amaze me that we do see these mistakes sometimes even in experienced credit unions. Don't be too loan growth focused. Sometimes credit unions that are offering new programs tend to trade credit quality for credit quantity. Additionally, they forget to look at the balance sheet and income statement in a holistic manner, if you will. We want to make sure that you consider things like liquidity requirements for new loan programs both in the long and short-term. Basically, that you have a plan to test the waters and gain experience and you are not solely focused on loan growth. Another common mistake that we see is lack of experience in credit unions. And when I say experience, I am not necessarily just talking about the two-year

regulatory requirement, but experience relevant to the structure of the credit union. For example, we'll sometimes see a credit union go out and hire a senior business loan officer from a local bank down the street. And that senior business loan officer may not have really done the credit analysis or underwriting on his loan for the last 10 or 15 years. He has had someone in the Loan Review Department or Credit Administration Department running those numbers for him. And he's probably also had someone in the Credit Administration Department or a loan secretary calling and following up with the servicing on those loans. So you just need to make sure that when you bring someone in internally to your credit union that they fit with the structure of your credit union, that they are not the entire loan department, if you will. Cash flow versus financial position, another common mistake that we see, and John touched on this little bit earlier is that credit unions focus more on a borrower's wealth or overall financial standing and the collateral that's available than they do on the underlying cash flow. It's very important that we be cash-flow lenders and maintain cash flow as the primary source of repayment in our underwriting decisions. Of course, personal guaranties and collateral are important, but we want to make sure that we focus on cash flows since that's what pays the monthly payments.

From an appraisal review perspective, we want to make sure that credit unions are critically analyzing the appraisals. Yes, we pay professional appraisers to make their assessments of a property or of equipment or inventory or whatever. We want to make sure as a credit union you critically analyze that appraisal. Make sure that the conclusions make sense to you in regard of what you have asked them to do. And then importantly that you have looked at the conditions or the recommendations that are contained in that appraisal. We'll sometimes find an appraisal in a loan file that recommends environmental assessment or environmental impact report be done on a property and it's never followed up on. But certainly, if there are environmental problems the credit union does not want to make those their own by repossessing collateral that's going to make the environmental problem their own. Property and collateral inspection, of course, this is something that's very important to do and we see many times that property or collateral inspection is done upfront and then not done periodically throughout the course of the loan.

Gigi Hyland: You had a great story that you shared with me yesterday, maybe you should share it with our audience, one of your previous experience.

Cory Phariss: Sure. Actually, I used to work in a bank out in West Texas and when I came on in the Loan Review Department one of the stories that they told me about...we had a guy that went out to count some cattle. And the rancher took him to the cattle pen and he counts all the cattle and the rancher puts him in the pickup and takes him down on the Back 40, and they have a good long talk. In the meantime, the ranch hands are moving the cattle to another pen. And the rancher brings the loan review specialist over to count the same cattle again. So another important point is to make sure that you have people that are familiar with the collateral. They know how to go out there and put their hands on it and understand that it is where it is supposed to be and it is what it's supposed to be. Lack of ongoing monitoring is another issue that we see. Failure to obtain

financial statements; I think sometimes credit unions are so member service driven that they are afraid to ask for financial statements. Certainly, we want to make sure that you get the information you need to make a good decision about the borrower, but also to help that borrower out along the way as you review their credit condition. And then finally, you need to have a contingency plan when you make a loan, particularly with specialized collateral, but really with any collateral. What's the first thing that is going to be need to be done if you have to go deal with a non-performing loan? And in the case of the SBA loans, we want to make sure that you really understand the process for requesting the guaranty purchase or for safeguarding collateral that you might need to repossess. With that, I know there are probably a lot of questions that participants have for John, so I will turn it back over to you.

Gigi Hyland: Great, thank you Cory. Thank you gentlemen for those presentations. They are very, very informative. I know, to the audience that we've given you a great deal of information in a very short period of time. We've obviously covered the SBA programs, how you might want to become an SBA-certified lender. We've have talked a little bit about the technicalities of NCUA's member business loan rule. We have also talked in fairly good detail about what examiners are thinking about as they come into your shop and some of the fairly long list of things you need to be aware of that really align with your other lending programs, but which make a great deal of difference in terms of SBA lending. What we are going to do is you may have been typing your questions all along, but we are going open up to questions and the answers. You will hear now a disembodied voice to my right, that is Anthony LaCreta, from....for one more day in Office of Examination and Insurance and then soon to be with Region One. He is going to read off some of the questions that we have received and direct them to the appropriate expert and we will hopefully try to answer as many as we can before the top of the hour. So Anthony, what's your first question?

Anthony LaCreta: We have got quite a few questions that have come in. Several of the questions that came in, and John this is for you. It pertains to the qualifications of the credit union. First and foremost is, do you have to have an existing commercial lending program in place to establish a relationship with SBA? What if we are in the very beginning stages of starting a member business lending program, can we still join up with SBA?

John Wade: Excellent question. When we are evaluating the capabilities of a lender participant, those who have developed a commercial lending practice already, those who have reported member business loans already on their call reports, call reports that we will review, will probably have a...what we call, an easier time but they will have a demonstrated history that we will be able to utilize in conjunction with the policies and procedures they have in place. That is not to say though that those who have never had a member business loan, haven't done business loans or haven't done the evaluation that we look at in a business loan. And to that end, we want to make sure that if an institution has not actually listed a member business loan on their books, but they do have loans where the characteristics for evaluating the credit are based upon the underlying small concern and its repayment ability through that loan or through the earnings that they generate

from that loan, we would like to know more about that, to the extent that you have that information, please share with our district offices. In addition, we will actually take a look at your policies and procedures a little more closely. We want to make the determination, do they understand what goes on in the practice of a commercial lending function? Do they know that it's going to take more than just originating and evaluating and closing on that loan? That there's going to be a lot that takes place once that loan is dispersed and those things will take place throughout the life of the loan. One of the comments I wanted to share just briefly here with regards to our guaranties for the audience to be thinking along these lines. Once that loan is dispersed and the guaranty has been put in place, it is good for the life of the loan. So to the extent that you can develop a servicing function and a liquidation function that really makes sure that your tickler systems for UCC filings or for your insurances are up-to-date and current for the underlying collateral you have, its that much longer that that particular guaranty will be in place and in force throughout the term of the loan. That means if you go five years down the road and now the thing finally goes into a financial default, our guarantee stands right there on the basis of the principal outstanding balance at that time. It hasn't changed. The only way it would have changed is if there had been changes in the level of servicing that you provide along the way. So, to answer the question specifically, we are predisposed to looking at those institutions that have a developed member business lending capability. However, I don't want to exclude people from thinking, if I haven't gotten in, I can't qualify. That's not true. But what we want to do is get a closer look and maybe a more thorough look with you as to what type of credit evaluations have you performed for businesses, for small businesses. Because I think that will give us an eye toward whether you will be successful as an SBA lender.

Gigi Hyland: That's a great advise John, because I think some credit unions may really be put off at the outset if they haven't done member business lending to say, okay, no I really can't do that. But I think the message that you are sending is a strong one, which credit unions really have to be aware that the SBA can be a partner upfront in really helping credit unions evaluate where this particular type of lending activity fits into the broader strategic plan of the credit unions lending activity, and so I think that's a very god advise. Anthony...

Anthony LaCreta: Another question, how is the...pertaining to the application process for credit unions applying to SBA, whereas, when you mentioned on your slide relating to the application process, you spoke about commercial credit policies, legal filings, recent call report, someone requested information about what did you mean by the legal findings?

John Wade: Legal filings?

Anthony LaCreta: Filings.

John Wade: Yes.

Gigi Hyland: I don't know, I am looking at our technical people. I don't know if we can get that slide back up or we can try. We'll try to get that up. So John, go ahead and answer the question.

John Wade: Thank you, thank you. The legal filings that we talk about are for no better term Corporate Governments 101. When you are making applications to become a lender participant, you are actually filing a formal contract with the government that if you follow the terms and conditions that are established for this loan program, we are prepared to guarantee those loans that you submit to us that meet those rules and regulations that we have in place. When it comes to the actual legal filing itself for the application, we look for A, a Board resolution. A Board resolution that simply states that a specific person or a specific individual or a specific position has been granted the authority by the Board to make application and execute documents on behalf of the credit union in relation to becoming a lender participant in this program. That probably is one of the largest legal filing that's done every single time we see an application. Now, one of the other elements that we again know that is part of your package that you have somewhere in your building is the actual articles and bylaws that you have of your formation. Many, many organizations have developed and have been acquired or have acquired other institutions along the way. We recognize that. We don't expect everyone to have the original charter that was established, although we are very impressed to know that there have been many different files that date back to the 1920s. Having said that though, we would like to make sure that the organization that...it is coming to us as a request for lender participation. It is the same organization that we have the underlying charter and bylaws for. Many times, like I said, there have been name changes. There have been transitions and we would like to carry that transitions in a documentation fashion in the file so that anyone, third party or otherwise, that comes to take a look at our application file thereafter, can make an easy read through the documents and say, credit union A, which became credit union B changed its name to C, and C was the name of the institution that came in to become a participant of our program.

Gigi Hyland: Okay (inaudible).

Anthony LaCreta: Another question posed by a credit union pertains to the qualification of credit unions that are not just community chartered. So the question is, is this something allowed for federal...all federally chartered credit unions or is it only opened up to community charter credit unions?

John Wade: I am going to...

Gigi Hyland: Go ahead, why don't you use the...

John Wade: I am going to ask the SBA's side of it here. It's an excellent question to ask insofar as until 2003, we had really tailored our programs to ensure that there was a community....a community basis for your establishing your common bond. In 2003 that particular ruling and interpretation by our general counsel was revised. We then opened the program to anybody to apply for consideration. Again, based upon capability, or

based upon the level of oversight and supervision, but it wasn't going to be a further review of the charter or the determinants of your common bond for credit union.

Gigi Hyland: Great. Frank, do you have any comments on that?

Frank S. Kressman: Yeah, and in similar circumstances with NCUA's, MBL rule. The rule only speaks to credit unions, but does not distinguish between the various charters.

Gigi Hyland: Great, so it really is open to all federal charters, that's really what we are saying?

Frank S. Kressman: And it's also applicable to state charters because other than seven states that have their own member business loan rule, federally insured state chartered credit unions are subject to our MBL rule.

Gigi Hyland: Exactly, great. Thank you. Anthony?

Anthony LaCreta: John another question and this pertains to the type of industry or business that is allowed to obtain SBA rules, and the question is, is there any type of industry or a particular business that is exempt from SBA lending?

Gigi Hyland: Good question.

John Wade: There are a number of business industries that we are concerned about, our proceeds being directed to. Your best resource for information on that actually comes within the context of our regulations, 13 CFR Part 120. Because in the 200 series for the no better purpose...that's the layman in me that knows this section of the regs, you will see the section devoted to what constitutes a permissible SBA loan and many of those restrictions are based not only on the type of institution, but also the type of the use of the proceeds from that institution. It's probably a more thorough answer than what I could give over here in a webinar format.

Gigi Hyland: Can you maybe provide one or two examples? We have got a lot of credit unions obviously in the mid-west that do agricultural lending. We have got...depending on the geography as we...a lot of times may dictate what type of business lending that credit union gets involved with. So can you give us some ideas to maybe one or two of those exemptions or what's not included?

John Wade: Yes, agriculture is a good area, a good topic because while we recognize the importance of being able to provide small business funding to agricultural concerns, the fact of the matter is we are not the primary lending arm for agricultural concerns. The US Department of Agriculture is, and so what we have done is tailored our regulations so that small business enterprises affiliated with farm enterprises are those considered eligible for small business loans through the SBA. It's a real fine line to determine what exactly constitute the agricultural concern versus the business enterprise that's associated with the agricultural concern because sometimes they actually could be on the same farm.

Gigi Hyland: Got it.

John Wade: Okay, but the idea here is this. We know the Department of Agriculture runs a wonderful loan program for agricultural concerns. And our specific statute is designed to ensure that there is no overlap in our program with theirs, and to that end we kind of restrict our boundary just to those farm enterprises inside of the small...that are small concerns within the ag side of the business.

Gigi Hyland: Okay, that's a good point and obviously on your slides, you have referenced a particular section of 13 CFR that credit unions can turn to, just by logging on to the Internet and doing some surfing and taking a look at that to see what those exceptions are. Okay. Anthony?

Anthony: John, two questions pertaining to the comment you made relating to centralized documentation, and one was, what is meant by the centralized documentation and the other is that what will the impact be on the local districts relating to the centralized documentation?

John Wade: We are still studying what that impact would be. What we have done though is spent time transitioning this particular agency. From an organization that...our district offices had all functions whether they will be loan processing, loan servicing and loan liquidation to a situation where these particular functions had been centralized for the most part. That is, a liquidation function now that actually takes place in Herndon, Virginia location. We actually have servicing that takes place in both Little Rock, Arkansas and Fresno, California. And these are specifically specialized servicing centers. The last of the steps is really the centralized processing of 7(a) loans and it really relates only to that segment that remains in our SBA portfolio that's not done through the Preferred Lender Program or through the SBAExpress Program. These are two delegated lending authority programs where much of the work is actually sent to a centralized facility. The last element, which usually covers about 15% of other units that we have in approval status, relates to those loans that are sent into our district offices and happens since the genesis of the program. We are now moving slowly and I want to say slowly because no sooner do I say we have got it started, then somebody steps in and says, "no not yet". But we are moving towards the idea of taking the last of the processing functions and moving them over into the centralized processing location so that all facets of the lending function, from processing, servicing and liquidation are all captured in a specialized, centralized area.

Anthony LaCreta: John another question...

Gigi Hyland: Anthony, we have about probably five more minutes, so why don't we wrap it up with three questions if you would, so shoot with the first one.

Anthony: I have combined several questions here, and it talks about the requirements to obtain SBA approval by the institution, by credit unions, and it says, what did you

got...number one, what will you estimate the overall time? Is it for submission of the required documents that are approved for SBA? And then what are the requirements? And I know that's going to be an extensive list and...

John Wade: No, actually it's not too bad. First of all, timing. As I alluded to in the presentation, if you have got all the seven filing elements done that are perfect and you have got the district office immediately sending that recommendation to our offices for final decision, those are the types of applications we can move through our office within a span of 30 days. What normally happens though is that every one of the 70 district offices will send an application in. They will wonder why it doesn't get processed in that 30-day time window and more importantly, the credit union has 30 days. And they don't realize that it may have been in the district office for 30 days or more than 30 days or more than 60 days. But that's largely due to the fact that they are under the same kind of operating pressures we have to get much of the work...their groundwork done as much as we are trying to get much of the groundwork in headquarters done. So to that end, if you have got your filing complete and you have got in your district office, your district office has made the recommendations to headquarters, once it's in headquarters, I have an obligation to take a review of that. I have it done and back to you within 30 days or at least back in the district office. The district office then will be making formal notification to you as to whether or not the decision has been to approve or not approve that credit union for lender participation. I mentioned seven elements. Seven elements come up because we took 21 elements, initially from a non-bank lender application, streamlined it down and said, "Look, this shouldn't have to apply to all of our credit units". Those seven elements include a current call report as well as the call report for the most recent fiscal year end, the Board resolution designating which particular officer or director...which particular officer or individual has been given the authority by the credit union to make application and execute documents related to this application for lender participation. You have the charters and the bylaws. You have the commercial lending policies. You have the statement or certificate, statement that you are not primarily engaged in the financing of an affiliate and then of course you have the NCUA share insurance certificate or a copy thereof. Those are the elements, and there are only six of them here. Those are the elements that basically construct what we call the application, a packet for a credit union to participate in our program. If you have those in, or say we have gotten it done to the point where when we have had...been at low tide, I have had some applications get through in two weeks time. So it really can happen. I know many of you are out there saying, "Oh well, mine has taken more than two weeks certainly", and it probably has. Some of that might be due to what they have been trying to capture at the district office. Some of that might be actually due to what we have been trying to capture at headquarters. Sometimes those calls can actually take place when they are at my desk. And it's only because somewhere along the line, we didn't ask the right question of you and so what we want to make sure is that we have everything in place so that we know that this particular application, this particular participant won't be questioned about why his application was referred towards a process something differently than everybody else's.

Gigi Hyland: Great.

Anthony LaCreta: John one question pertaining to the best way to contact the nearest SBA office? Web...by web?

John Wade: Wow! Good. Yeah, each of our district offices have a specific website themselves designated for their area. However, if you go to [www.sba.gov](http://www.sba.gov) and then type into the link that we have for our district offices, it will take you on the hyperlink channel right to the specific district office for your location. And bear in mind, some states, Texas, California, Florida in particular, Iowa, Wisconsin have two district offices or three, and in case of California, I believe we have five. So you want to make sure you have got it, whether it's Northern California or Southern California. You will also note, ironically, if you go to your phonebook and take a look in your phonebook, under the US government locations, it'll list the SBA district office there for you.

Gigi Hyland: That's great. Anthony how about one more question?

Anthony LaCreta: Oh no, we have several of them. But one question that is asked here is pertaining to performance of the loans. A loan's performance begins (inaudible) John, what degree of latitude are credit unions given in an SBA workout scenario? Does an extension or modifications in the term affect the underlying guaranty?

John Wade: Good question. Part of the answer to that really revolves around whether or not that particular loan and the guaranty portion of that loan were sold in the secondary market. You will lose much of your flexibility in making loan modifications if in fact the guaranty portion of the loan has been sold in the secondary market, why? Because the secondary market investor has made his decision to purchase that guaranty portion or the interest thereof on the basis of the terms and conditions that were established with it at the time it was submitted for purchase. Now, what it means to you is, if there is a servicing function, and specifically if there is a servicing arm that tries to make the modification subject to, or for the benefit of the small business, we are more inclined to take a close look at that and see whether or not this small business is better for it because of it. Loan modifications run the gamut. They go from increasing the size of the loan originally that's dispersed to whether or not collateral can be released. Many of these questions will fall back to what happens to the SBA's interest as a result of that condition and to extent that the SBA's interest itself is not adversely affected. The SBA has a servicing arm, has a servicing unit in both Little Rock and Fresno that stands ready to take on any of these servicing actions for the purposes of providing our approval, so that the credit union can continue to work with that small business borrower and get through a workout scenario.

Gigi Hyland: That's great. Thank you John. Looking at the clock and I know we are running right up against our hour. There seem to be a great deal of questions, a great deal of interest in this topic based on all of the questions that Anthony is reading and looking at. From here on now, just to give you a sense of what happens from here. We are obviously going to sign off on the webinar but in about a week or so, the folks that we use to help us with the webinar are going to make a transcript available and if you either

had to leave the webinar or you have some other folks and staff that may be interested in seeing this webinar, it will be available for an additional 90 days. And what will happen is, if you are registered for the webinar, you are actually going to get an e-mail notification that the webinar has been archived and that you can access it with the same link and with the same information that you were given to access it for about 90 days. NCUA will also send out a reminder. We will do immediate advisory, advising you of that and from there, if you have additional questions, I am going to give you my e-mail address. It's [boardmemberhyland@ncua.gov](mailto:boardmemberhyland@ncua.gov). If we didn't have an opportunity to answer your question and you feel a burning need to have it answered, please go ahead and e-mail me, I will pass it along to John. You can also use the resources that John offered on his slides in terms of contacting your local SBA office. With that, I want to thank you gentlemen, you have done a great job sharing your expertise. I really appreciate your participation. We hope you, the audience, have enjoyed participating and listening in on this conversation and we wish you a good afternoon. Thank you, bye-bye.